

a

DIRECTOR-GENERAL OF INLAND REVENUE

v.

EUROMEDICAL INDUSTRIES LTD.

FEDERAL COURT, KUALA LUMPUR

WAN SULEIMAN FJ

b

ABDUL HAMID OMAR FJ

MOHD. AZMI FJ

[CIVIL APPEAL NO. 17 OF 1981]

2 APRIL 1983

c

REVENUE LAW: *Assessment of income tax - Section 4(d), Income Tax Act 1967 - Whether correct - Section 4(a), Income Tax Act and Double Taxation Relief (United Kingdom) Order, 1973 - Company resident in the United Kingdom - No permanent establishment in Malaysia - Whether payments royalties - Section 2, Income Tax Act - Article XI, Clause 3, Relief Order - Whether income - Article VI, Clause 1, Relief Order - Conflict between the Income Tax Act and Relief Order.*

d

The Special Commissioners of Income Tax confirmed the assessment of income tax made under s. 4(d) of the Income Tax Act 1967 by the appellant (DGIR) upon the respondent company (EIL), incorporated in the United Kingdom, in respect of certain payments it received from Euromedical Industries Sdn. Bhd. (EISB), a company with its registered office in Penang. On appeal, the High Court held that there was no legal basis for the DGIR to charge income tax under s. 4 of the Income Tax Act [1967] ("the Act") and that the presumptive provisions of s. 15(b) did not apply and allowed the appeal. The appellant appealed.

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Held:

[1] The payments were made to a company (EIL) resident in the United Kingdom with no permanent establishment in Malaysia.

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[2] The payments might come within the definition of royalty under s. 2 of the Act but did not come within the definition of Clause 3 of Article XI of the Double Taxation Relief (United Kingdom) Order 1973 and under s. 132(1) of the Act. The provisions of the Relief Order prevailed over those in the Act. [*Ostime (H.M. Inspector of Taxes) v. Australian Mutual Provident Society* 38 Tax cases 492 at 509 applied; *Director-General of Inland Revenue v. Phaltan Sugar Works Ltd.* [1983] CLJ (Rep) 131; [1983] 1 MLJ 174 distinguished].

g

[3] Clause 1 of Article VI of the Relief Order was applicable and the payments were income for management services taxable only in the United Kingdom.

[Appeal dismissed.]

Cases referred to:

Ostime (H.M. Inspector of Taxes) v. Australian Mutual Provident Society 38 Tax Cases 492

Director-General of Inland Revenue v. Phaltan Sugar Works Ltd. [1983] CLJ (Rep) 131; [1983] 1 MLJ 174

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Legislation referred to:

Double Taxation Relief Order 1973 [UK], arts. VI Clause 1, XI Clause 3

Income Tax Act 1967, ss. 2, 4, 4(d), 15(b), 132(1)

For the appellant - Mokhtar Hj. Sidin, SFC

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For the respondent - James Puthucheary; M/s. Skrine & Co.

JUDGMENT

Wan Suleiman FJ:

The Special Commissioners of Income Tax confirmed the assessment of income tax made under s. 4(d) of the Income Tax Act 1967 by the appellant (DGIR) upon the respondent company Euromedical Industries Ltd. (EIL) in respect of certain payments it received from Euromedical Industries Sdn. Bhd. (EISB).

EIL appealed, and the question for determination by the High Court was whether the assessments were correctly made, having regard to the Double Taxation Relief (United Kingdom) Order, 1973 and to s. 4(a) of the Act.

EIL was incorporated in the United Kingdom and, for the purposes of Malaysian Income Tax, is resident there and has no permanent establishment in Malaysia. On 9 May 1973 it entered into an agreement with a Malaysian company, Plantations Agencies Sdn. Berhad (PASB) to set up EISB in Malaysia with its registered office in Penang for the purpose of manufacturing catheters. This agreement (AB23) provides, *inter alia*, for EIL to appoint three directors to the board of EISB and for these directors and for other EIL employees to provide managerial, planning, training, technical, operational, marketing and development services to EISB. In the result, EISB paid to EIL the following amounts as managerial fees:

Period	Amount
From 1 June 1973 to 31 December 1973	RM35,217
Year ending 31 December 1974	RM56,134
Year ending 31 December 1975	RM49,152

DGIR treated these payments as royalties within the definition of s. 2 of the Income Tax Act, 1967 and accordingly made assessments on EIL under s. 4(d).

It was common ground that the payments were management fees which were paid to a company resident in the United Kingdom with no permanent establishment in Malaysia. It was also agreed that the payments would come within the definition of "royalty" under s. 2 of the Act but not within the definition of Clause 3 of Article XI of the Relief Order.

The learned Judge considered s. 132(1) of the Act which reads -

If the Minister by statutory order declares that -

- (a) arrangements specified in the order have been made by the Government with the government of any territory outside Malaysia with a view to affording relief from double taxation in relation to tax under this Act and any foreign tax of that territory; and
- (b) it is expedient that those arrangements should have effect,

then, so long as the order remains in force, those arrangements shall have effect in relation to tax under this Act notwithstanding anything in any written law.

and decided that in the event of a conflict such as that shown in the present instance, the provisions of the Relief Order would override those in the Act.

It would follow from this line of reasoning that the payment of management fees to EIL is not royalty, but is income for the management services it provides to EISB in compliance with Clause 5 of the Heads of Agreement entered into between EIL and PASB on 9 May 1973 for the establishment of EISB (see Agreement AB23).

a Article VI Clause 1 of the Relief Order provides -

1. The income or profits of an enterprise of one of the Contracting States shall be taxable only in that Contracting State, unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, tax may be imposed in that other Contracting State on the income or profits of the enterprise but only on so much thereof as is attributable to that permanent establishment.

b Referring to this Clause, his Lordship went on to say that since the Article XI definition of “royalties” does not apply, then any income of EIL is taxable only in UK since it does not carry on business in Malaysia through a permanent establishment here. Since the provision of the Relief Order is unambiguous and applies in this case, he therefore did not consider it appropriate to apply the presumptive provisions of s. 15(b) of the Act, and in consequence there was no legal basis for the DGIR to charge income tax under s. 4 of the Act.

c Counsel for the appellant (Revenue) aver that the only point in dispute is whether, having found that the sum in dispute is royalty within the meaning of s. 2 of the Act, the learned Judge could then hold that because the definition of “royalties” in Article XI did not apply, Clause 1 of Article VI would then become applicable and the management fees paid to EIL would therefore be income taxable in the United Kingdom only.

d It appears to us that the learned Judge never intended it to be understood that he had found the management fees to be royalty under s. 2 of the Act. What he obviously means is that whilst the parties agree that the fee does appear to come under the definition of “royalty” under that section, it does not come within the definition of that term in the Relief Order, and that because under s. 132(1) of the Act in the event of conflict the provisions of the Relief Order should prevail, the fees should be treated as income or profit and not as royalty.

e This provision is not peculiar to our tax law. Counsel for the respondent drew our attention to a similar provision in the United Kingdom Income Tax Act, 1918 where in the event of any inconsistency between the provision of the Act on one hand and a Double Taxation Relief Agreement on the other, the Agreement must prevail over the Act - see *Ostime (H.M. Inspector of Taxes), v. Australian Mutual Provident Society* 38 Tax Cases 492.

f We were also referred to the decision of this Court in *Director-General of Inland Revenue v. Phaltan Sugar Works Ltd.* [1983] CLJ (Rep) 131; [1983] 1 MLJ 174 (Federal Court Civil Appeal No. 39 of 1981) which learned Counsel for Revenue submits is on all fours with the present appeal and is therefore applicable to the present appeal.

g The great difference between these two cases is that in *Phaltan Sugar*, there is no conflict between the definition of “royalty” under the Act and that in the Indian Order, though the definition in the Act is wider in its scope, so that s. 132(1) of the Act does not operate.

The *Phaltan Sugar* decision does not therefore assist Revenue.

We would therefore dismiss this appeal with costs.

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Also found at [1983] 1 CLJ 281

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